Market Strategy
by STRATEGAS A BAIRD COMPANY

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Market Strategy Weekly

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This week we spoke with Strategas Chief Investment Strategist Jason Trennert on why his team is bullish on the market despite recent volatility and key unknowns like interest rates, inflation, and tax policy. That conversation—lightly edited for length—is below.

Jason Trennert, Strategas
Chairman, CEO, Chief Investment Strategist

Ross Mayfield, Baird PWM Research
Investment Strategy Analyst

RATES STILL RISING | INFLATION TOP OF MIND | POSITIONED FOR REAL GROWTH

ROSS MAYFIELD: Despite the big jump in rates this year (the 10-yr Treasury touching 1.75% after starting the year below 1.00%), you recently wrote that higher long-term interest rates don't particularly scare you. Could you explain that a bit?

JASON TRENNERT: We're spending a lot of time looking at the equity risk premium, which is essentially the earnings yield on the stock market. And right now, it's quite positive vs. the 10-yr Treasury yield (by ~3.00%). If you look at periods that saw big bull market peaks, equity risk premium was actually negative in those periods (bond yields *higher* than the stock market's earnings yield). Take March 2000: 10-yr Treasury yields were around 6.00% and the Fed had been tightening pretty aggressively. So that's why **we're not overly worried about long-term rates, especially when they're moving higher for "the right reasons" – i.e. higher growth expectations.** Although there's plenty of rotation under the surface of the market that reflects this move in rates, as well.

ROSS: The comparison to 2000 has come up a lot recently, but you note the key distinction is how different the bond market and Fed were then. So today, the Federal Reserve indicated low rates for the foreseeable future and a general lack of concern about near-term inflation. Where do you stand on inflation and at what point does that start to become a concern?

JASON: I think inflation becomes concerning when the Fed starts fighting it (e.g. raising rates). We may collectively worry about what the future will look like, but **it's not until the Fed starts to fight inflation aggressively that it becomes a real problem for the market.** I do think inflation is going to be higher this year given the amount of stimulus, but in my opinion, the fact that the Fed isn't worrying about it means that at least for this year the market can withstand higher inflation. The question will become "can the Fed maintain control if things start to heat up," but for the time being, it's game on.

ROSS: A thin line for sure. Let me ask a final question: The basis of the piece was "bullish despite the unknowns," so how are you positioning for this kind of market environment?

JASON: We have a strong bias towards Value over Growth. We're overweight Financials, Energy, Materials, and Industrials. **At the beginning of the year, we moved toward a more traditional early-cycle, heavy-cyclical positioning** (e.g. upgrading Financials and Energy, downgrading Tech and Communication Services). Again, the issue in Tech is that it will probably get hurt the most by higher rates in the short-term, but we also expect there to be some bifurcation and subtlety as to which Tech firms can withstand this new environment better than others. For instance, the high-flyers without any earnings at all might have real problems, while the more robust businesses will hold up fine.

ROSS: Jason I want to thank you again for joining us for a few minutes today.

JASON: My pleasure, thank you.

Sector Allocation U.S. Equities

OVER	Industrials
	Financials
	Energy
	Materials
NEUTRAL	Technology
	Communications
	Healthcare
	Discretionary
UNDER	Utilities
	Real Estate
	Staples

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